controller, from the programmer's customer management system.[62] That interface with the VAM permits programmer-customers to add and delete individual subscribers' video service, schedule video programming, retrieve billing information, edit individual channel parameters and generally provision service to their end user subscribers over the video dialtone network.

Rainbow was never told that it is required to use any particular software in order to interface with Bell Atlantic's network. To the contrary, Rainbow has been assured that it can develop its own software or obtain it from a third party vendor,[63] and Bell Atlantic has publicly disclosed, in accordance with the

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[62] *See* Declaration of John C. Phillips, ¶¶ 3-7 (Dec. 20, 1995) ("Phillips Decl."), attached as Exhibit G. This requirement was initially described at a seminar for potential video providers in Dover held on March 9, 1995, at which they were informed that programmer-customers would need to provide "hardware ***and software*** to interface with the VAM," *see* seminar handout entitled "Bell Atlantic Video Dialtone Service, March 1995," at 9, attached as Exhibit H. The seminar was widely advertised; in fact, representatives of Rainbow's parent company, Cablevision Systems, attended that seminar.

In addition, Bell Atlantic published the technical specifications for that software interface, TESP-0106 (*see* Tariff F.C.C. No. 10, 1st Revised Page 4), as required by the Commission's rules, and delivered copies of those specifications to Rainbow on May 10, 1995. *See* letter from Hardy F. Moebius, Bell Atlantic, to Andrea Greenberg, Rainbow Programming Holdings, Inc., dated May 10, 1995, attached as Exhibit I (without attachments).

Finally, Bell Atlantic's proprietary handbook for its video information providers, which was provided to Rainbow on July 6, 1995, *see* letter from Mr. Moebius to Ms. Greenberg, dated July 6, 1995, attached as Exhibit J (without attachments), reiterates that it is the programmer-customer's responsibility to obtain or provide compatible software, and that software would be available for licensing by those who were interested in pursuing that option.

[63] *Id.*

Commission's rules, the technical specifications to allow them to do so.[64]

Rainbow concedes that Bell Atlantic has offered, as a licensee of the software developer and owner, to license this software to Rainbow. By its own admission, Rainbow did not even indicate an interest in licensing this software until November 13, 1995. Bell Atlantic then indicated that it would develop a proposal for such a licensing agreement. Bell Atlantic is doing so, but had not completed the internal work required to prepare and obtain authorization for the proposal before Rainbow filed its Opposition on November 30.[65]

In short, Rainbow may develop its own software to perform this function, lease existing software from Bell Atlantic or the software owner and developer, or contract with another third-party vendor to develop similar software.[66] With all of those options, Rainbow cannot credibly assert that this software must be provided as a basic or adjunct to basic service under tariff.

Moreover, the Commission could not lawfully require provision of this software as a tariffed service. If Bell Atlantic were to license or otherwise provide this software to programmer-

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[64] *See supra* n. 61.

[65] Phillips Decl., ¶¶ 12-13.

[66] In fact, Bell Atlantic publicly stated that video information providers have those options in pleadings filed in support of its Section 214 application for the Dover build in 1994. *See* Reply of Bell Atlantic (New Jersey Bell) to Response in Support of Motion for Investigation, at 7-8 (May 20, 1994).

customers, it would simply deliver a computer disk to the programmer-customer, who would load it on a computer at the programmer-customer's location. Bell Atlantic would not provide any communication by wire or radio in connection with that transaction. As a result, the provision of the software could not be subject to regulation as a common carrier service under Title II of the Communications Act of 1934, or be subject to the Commission's exercise of ancillary jurisdiction under Title I of the Act, because the Commission only has jurisdiction over communications by wire or radio.[67]

Nor could provision of software to provide this interface be considered "adjunct to basic," as suggested by Rainbow. Services that are adjunct to basic are network-based services that may nominally meet the definition of an enhanced service, but that perform a network function.[68] Provision of software on a computer disk is not a "network-based" service; in fact, it clearly stands completely separate from Bell Atlantic's network. In addition, the software does not perform a network function; it simply provides an interface from a third party to the network.

As a result, Rainbow's complaint concerning the interface access software is entirely without merit.

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[67] *See, e.g.*, 47 U.S.C. §§ 151, 152(a), 201(a) and 203(a).

[68] *See* **North American Telecommunications Ass'n, Petition for Declaratory Ruling Under Section 64.702 of the Commission's Rules Regarding the Integration of Centrex, Enhanced Services, and Customer Premises Equipment**, 101 FCC 2d 349, 356-361 (1985), *modified on recon.* 3 FCC Rcd 4385 (1988).

Rainbow also complains that the Commission should regulate provision of digital converters or "set top boxes" under its Title I jurisdiction on the purely speculative surmise that one or more of its competitors may be able to obtain this equipment at better rates than Rainbow can. Again, Rainbow's assertion of the facts and the logic of its reasoning are flawed.

First, Rainbow has acknowledged again that it has options here as well: it can either lease a set top box from Bell Atlantic, or obtain it directly from the manufacturer of Bell Atlantic's set top boxes.[69] What Rainbow fails to acknowledge is that Rainbow also has had the option to develop, or to work with any other third-party vendor to develop, its own set top box. Bell Atlantic publicly disclosed the required technical specifications with ample time to permit Rainbow to do so,[70] and specifically delivered a copy of the specifications to Rainbow earlier this year.[71]

Second, Bell Atlantic proposes to lease these converters to programmer-customers, including Rainbow, on commercially reasonable terms,[72] and with good reason: Bell Atlantic has every

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69 Rainbow Opp., at 24.

70 *See* TR-72550 (issued May 1994). *See also* Tariff F.C.C. No. 10, 1st Revised Page 4.

71 *See* Phillips Decl., ¶ 16; see also Exhibit I.

72 That $6.00 a month or $72 per year fee (plus a one-time $10.00 activation fee) includes far more than the mere rental of the converter; it also includes installation and maintenance of the converter and installation and maintenance of inside wiring for the programmer's end user subscriber.

incentive to encourage multiple programmer-customers to offer service over the Dover system, not to erect additional entry barriers. But if Rainbow is not satisfied with the particular options offered by Bell Atlantic, it may cut its own deal directly with Philips Electronics, the manufacturer of the converters Bell Atlantic has offered to lease, build its own converter or contract with another vendor to develop one for it. With this plethora of reasonable options, Rainbow has nothing about which to complain, and has given the Commission absolutely no reason to change its longstanding rules concerning the non-regulated provision of customer premises equipment.

IV. <u>The Other Objections to This Tariff Are Meritless</u>

Bell Atlantic has already fully responded to many of the other objections raised by commenters concerning the terms and rates of this tariff. In this reply, therefore, Bell Atlantic will respond only to the handful of additional issues raised.

New Jersey Cable Television Association ("NJCTA") contends that Bell Atlantic has not demonstrated that pointcast services will recover the costs of the remaining 79 channels of capacity for the video dialtone service.[73] But as NJCTA itself notes, Bell Atlantic has estimated that the cost of 40 of those channels will in fact be recovered from additional demand for broadcast channels.[74] Moreover, NJCTA's comment simply ignores

73 NJCTA Opp., at 21.

74 *See* Direct Case, Issue G(1).

the detailed explanation Bell Atlantic has provided for its assessment that anticipated revenues from the remaining 39 pointcast channels will more than recover the investment associated with that capacity.[75]

With regard to term and volume discounts, NCTA asserts that it is unlikely that smaller programmers will benefit from discounts from resellers because resellers are not common carriers and will favor established programmers over smaller operators.[76] This is contrary to common sense. Larger, established programmers will not need the services of a reseller; it is only less established, smaller programmers who do not wish to undertake in full the financial or term commitment required to obtain the benefit of the discount that are likely to use the resellers' services.

While Rainbow asserts that a five year term is unreasonably long to commit to a new and unproven transport service,[77] Rainbow retains the option to purchase service on a month-to-month basis until it feels that the discount is worth that commitment. In effect, Rainbow wants all of the upside without any of the risk-sharing: it wants the discount it could obtain by making a 5-year commitment while only buying service month-to-month, depriving Bell Atlantic of any of benefits it expected in

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[75] *Id.*

[76] NCTA Opp., at 22.

[77] Rainbow Opp., at 29.

offering that discount. Moreover, Bell Atlantic has offered to consider amending its tariff to provide shorter term discounts upon receipt of a bona fide request to do so.[78] While complaining bitterly about the existing tariff terms, Rainbow has not made a request for a shorter term discount option -- either in its Opposition or informally to Bell Atlantic -- nor has anyone else.

Rainbow repeatedly asserts, without any foundation, that "affiliated and favored VIPs [will] not be adversely affected" by certain tariff provisions, such as the early termination penalty and late payment fee, because enforcement of these terms would result only in the "nominal transfer of the penalty monies from one pocket to another."[79] Rainbow suggests that one of its competitors, FutureVision, is such an affiliated programmer-customer. But Bell Atlantic has no current or contingent ownership interest in FutureVision that would make FutureVision an affiliate

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[78] *See* Direct Case, Issue K(2), at 92.

[79] Rainbow Opp., at 31.

of Bell Atlantic under the Commission's rules.[80] Consequently, Rainbow's argument is irrelevant.[81]

Rainbow's assertions that substitute programmer-customers might prefer to lease channels established by a terminating programmer cuts against its argument that the tariff's termination liability provisions are unfair.[82] If Rainbow wishes to terminate service before its contract expires and Rainbow believes there is value in its channel assignments (Channels 1-192), it could find such a substitute programmer *before* giving notice to terminate. Rainbow might end up paying for a few more months of service in the short term under this strategy, but could avoid triggering the 5-year termination liability provisions.

Rainbow also complains that the tariff's threshold for service interruptions that would enable it to avoid termination

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[80] See 47 C.F.R. § 64.54(e)(1).

[81] Through a series of mischaracterizations and innuendo, Rainbow also strenuously attempts to create an aura of "favoritism" by Bell Atlantic toward FutureVision. As Bell Atlantic has explained, *supra* at 22-28, Rainbow has had access to the same technical information as FutureVision has had, which would enable Rainbow to develop or arrange for third party vendors to develop, software and digital converters. Bell Atlantic has also previously explained in detail the binding contractual requirements that prohibited it from requiring FutureVision to participate in the open enrollment process with regard to the 60 channels of capacity FutureVision reserved three years ago. *See* Letter from Marie Breslin, Bell Atlantic, to Kathleen Wallman, Chief, Common Carrier Bureau, Federal Communications Commission, dated April 7, 1995. Bell Atlantic was only able to obtain a channel reservation prepayment for those channels because FutureVision *voluntarily* agreed to provide it; absent that agreement, a regulatory decision to require such a prepayment would have placed Bell Atlantic in breach of its contractual obligations.

[82] Rainbow Opp., at 33.

liability is unreasonable.[83] That provision allows a programmer-customer to terminate service without liability if the programmer-customer suffers service interruptions to more than five percent of its subscribers for more than one hour per day for more than 30 days in any 90 day period, or a continual outage of more than five days affecting more than five percent of its subscribers. The reasonableness of this provision is demonstrated by a concrete example of its application.

With regard to the first prong of the test, assume that a programmer-customer is providing programming for 24 hours a day and that the programmer has achieved a 20% penetration rate. Under that assumption, Bell Atlantic is delivering approximately 993 million minutes of programming to that programmer's subscribers during any 90 day period.[84] Under the first prong of the test, a programmer would escape any termination liability if **less than one tenth of one percent** of the programming minutes (689,400 minutes)[85] delivered by Bell Atlantic during that period were affected by service outages -- a reasonable standard by any calculation. Moreover, the second prong of the test, which permits the programmer-customer to terminate service without liability if there is a continual outage of more than five days affecting more than

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[83] *Id.*, at 33-35.

[84] 24 hours x 60 minutes per hour x 7,664 subscribers [20% penetration of 38,319 potential end user subscribers) x 90 days = 993 million minutes of programming.

[85] One hour x 60 minutes per hour x 383 subscribers [.05 x 7,664 subscribers] x 30 days = 689,400 minutes of programming.

five percent of its subscribers, provides yet an additional safeguard for Bell Atlantic's programmer-customers.

Rainbow's fear that Bell Atlantic will only respond to service outage problems experienced by "favored" programmers has no basis and is contrary to common sense.[86] First, Bell Atlantic has a nondiscrimination obligation with regard to the basic network transport service it provides all programmer-customers. Second, it is not in Bell Atlantic's interest if any programmer-customer's subscriber is without service a minute longer than absolutely necessary; poor service quality and reliability will damage the public perception of Bell Atlantic's network. Moreover, if programmer-customers are not successful in retaining customers, they will withdraw from service and diminish Bell Atlantic's revenues from video dialtone service.

With regard to the requirement that Bell Atlantic receive notice from the programmer-customer of a network problem before the 4-hour clock for service outage credits begins to run, that is a commercially practical way to administer the credit system. First, if an end user reports a problem, the problem may be in the signal coming from the programmer's head end, not in Bell Atlantic's network. In that case, the service outage clock should not be triggered. Second, unless the parties (Bell Atlantic and the programmer) agree on when the clock has started and stopped, billing disputes are likely to arise. Finally, even if the service

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[86] Rainbow Opp., at 40-41.

outage credit clock has not formally started, Bell Atlantic would, of course, immediately seek to identify and correct any service outage problem as soon as it becomes aware of the problem, no matter what the source of the trouble report.

Rainbow also contends that Bell Atlantic should be liable for consequential damages it may sustain, i.e., any resulting loss in revenues and refunds to end user subscribers, if there is a video dialtone service interruption during, for example, a pay-per-view event.[87] It is black letter law, however, that a contracting party cannot be held liable for such special or consequential damages absent specific knowledge of the potential for such damages and agreement to undertake the risk of such damages.[88] Moreover, Rainbow has provided no justification for the Commission to impose greater liability on Bell Atlantic for this tariffed service -- by requiring responsibility for consequential damages -- than Bell Atlantic has for its other federal and state tariffed services. Indeed, such open-ended liability would serve to discourage the introduction of any new service, including video dialtone.

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[87] *Id.*, at 41.

[88] Williston on Contracts, §§ 1356 and 1357 (3d ed. 1968).

Conclusion

The Commission should close its investigation without requiring any modification to Bell Atlantic's video dialtone tariff.

Respectfully submitted,

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A

Exhibit A

Additional Clarification of Tariff Provisions

While once again not attempting to catalog exhaustively each of commenters' misunderstandings and incorrect assertions, Bell Atlantic summarizes below certain additional concerns raised by the parties and its response to each.

1. **Issue**: All of Bell Atlantic's investment in cable and wire facilities is being recovered through Category 1 (local exchange), which result in a 75% allocation to the intrastate jurisdiction. (MCI Opp., at 11.)

   Response: All video dialtone costs will be categorized as Category 2 (wideband), and 100% of these costs will be allocated to the interstate jurisdiction.

   Part 36.155(a) of the Commission's rules requires that cable and wire facilities be assigned directly to the interstate or intrastate jurisdictions, where feasible. Moreover, the Commission's rules also provide for carriers to categorize cable and wire facilities costs on the basis of engineering studies or other objective criteria. *See* 47 C.F.R. § 36.151(c). Consequently, the cost of the cable and wire facilities for Bell Atlantic's Dover network will be allocated to video dialtone and non-video dialtone services using appropriate engineering records, which is comparable to the methodology used in Bell Atlantic's tariff for pricing purposes.[1] All video dialtone costs will be categorized as Category 2 (wideband). Because the Dover system will initially carry as a video dialtone service only video programming that has originated as radio or satellite-delivered signals, 100% of Category 2 wideband costs will be allocated to the interstate jurisdiction.[2]

2. **Issue**: Application of Bell Atlantic's methodology results in an allocation of 42% of shared investments to video rather than 28%. (MCI Opp., at n.16.)

   Response: Bell Atlantic used only investment in the integrated portion of the network (from the Host Digital Terminal (HDT) to the end user customer's premises) to develop

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1 *See* Direct Case, Issue C.

2 If and when intrastate video dialtone services are offered over the Dover system, an appropriate portion of the Category 2 cable and wire facility costs will also be allocated to the intrastate jurisdiction.

the 28% allocator. In addition, 100% of all video only portions of the network were directly allocated to this video dialtone service.

MCI has incorrectly applied Bell Atlantic's methodology to the integrated portion of the network plus the video only portions of the network (e.g., the video access links and other equipment that support this video dialtone service before it enters the HDT). MCI's application of the methodology is inappropriate because it does not consider the allocation of the voice only pieces of the network that occur before the telephony stream enters the HDT. *See* Direct Case, Issue C(1).

3. **Issue**: Bell Atlantic should be required to assign all network interface device (NID) costs to video dialtone service. In addition, Bell Atlantic describes the NID inconsistently in two places in its filings (MCI Opp., at 19.)

   Response: Bell Atlantic has in fact allocated all of the investment associated with the NID to video only investment. *See* Tariff, Description & Justification, Workpaper 5-4, line 6; Transmittal No. 741-Amended, Tab 4, at p. 5 (May 5, 1995). With regard to the discrepancy, Bell Atlantic defined the NID in the Description & Justification (for descriptive purposes only) simply as an "adjunct modular plug which is added to the existing telephone interface," Tariff, Description & Justification, at 3-9, although Bell Atlantic's cost support correctly identifies eight separate components as being investment in the NID. *See* Transmittal No. 741-Amended, Tab 4-I. This minor discrepancy in no way affects the cost study.

4. **Issue**: The interest rate on late payments of 0.937%, if compounded on a monthly or daily basis, is 11.84%. (Rainbow Opp., at 35.)

   Response: Bell Atlantic calculated its monthly interest rate of 0.937% by dividing its annual cost of capital at the time the tariff was filed (11.25%) by 12 months. Bell Atlantic will not compound interest on a monthly or daily basis on late payments.

5. **Issue**: In its Direct Case, response A(7), Bell Atlantic categorizes fiber facilities as shared equipment, yet in response B(6) inconsistently describes "fiber connections from the video distribution office to the system's host digital terminals" as video only equipment. (NJCTA Opp., at 35.)

   Response: The fiber facilities described in response A(7) are the fiber facilities between the HDT and the ONU, which are appropriately categorized as shared equipment because they carry both video dialtone and telephony/other transmissions.

In contrast, the fiber connections described in response B(6) are appropriately categorized as video only because these facilities carry only video dialtone transmissions. Telephony/other feeds would be carried over separate fiber facilities and join the video dialtone stream at the HDT. *See also*, Tariff, Description & Justification, Section 3, Workpapers 5-3, 5-4, 5-8 and 5-9; Transmittal No. 741-Amended, Tab 4, at pp. 5 and 11 (May 5, 1995).

6. **<u>Issue</u>**: Bell Atlantic provides inconsistent lists of what it has categorized as "shared" equipment in its Direct Case responses to Pre(1), A(7), B(5) and B(6). (NJCTA Opp., at 34-36.)

   <u>Response</u>: Bell Atlantic's response to Pre(1) contains the complete list of all equipment categorized as shared. In response A(7), the quad current limiter inadvertently was not included on the list. That ONU powering equipment is also incapable of measuring relative use among video and telephone/other services transported over the integrated system.

   The reason Bell Atlantic singled out only certain shared equipment in its responses to B(5) and B(6) was to give an accurate response to the Commission's particular question in each case. In response B(5), Bell Atlantic was required to provide a listing of the video dialtone system's components *by component subsystem*, categorized as incrementally caused by video dialtone service, voice service or unidentifiable as either. The only pieces of equipment in the Dover Township video dialtone network that are comprised of component subsystems that can be categorized in this manner are the HDT, ONU and quad current limiter. Similarly, in response B(6), the Commission requested a description of the broadband network that would be deployed absent the video dialtone service, and particularly asked for a description of the HDT, ONU, drop facilities and quad current limiter. While Bell Atlantic's text response makes particular mention of this equipment, its cost calculations in Attachment B(6) include the full list of shared equipment categories, consistently with response Pre(1).

7. **<u>Issue</u>**: NJCTA cannot tell how Bell Atlantic's conduit factor was calculated. Although Bell Atlantic states that it was calculated in the same manner as the pole factor, the pole factor was calculated using the ratio of total pole investment to total aerial investment. There is, however, no relationship between total aerial investment and conduit space. Did Bell Atlantic estimate its conduit factor utilizing a ratio based on the relationship between total conduit investment to total underground investment? (NJCTA Opp., at 25.)

Response: Yes, as was stated in Transmittal No. 741-Amended, Tab 7, at pp. 4-5 (May 5, 1995).

8. **Issue**: It is impossible to determine whether Bell Atlantic has correctly calculated its pole and conduit factors because it merely provides the end result of its calculations for each video dialtone system subelement. (NJCTA Opp., at 25.)

   Response: The methodology for specific pole and conduit factor calculations is shown in Transmittal No. 741-Amended, Tab 7 at 4-5 (May 5, 1995), and the actual calculations are fully described in Direct Case Attachment Pre(1). NJCTA, therefore, has the underlying data (e.g., specific accounts and investment dollars) as well as the methodology with which to verify Bell Atlantic's pole and conduit factor calculations.

9. **Issue**: It is not clear whether the total investment figures used in calculating the pole and conduit factors are for the entire state of New Jersey or only for Dover Township. (NJCTA Opp., at 25.)

   Response: As NCJTA itself points out (NJCTA Opp., at 27), Bell Atlantic has consistently calculated the investment for pole and conduit throughout the Direct Case and all previously filed information. The documentation always refers to the video dialtone build in Dover Township and not the entire state. In addition, Attachment H(1) provides source information that is clearly identified in a footnote as "Dover Township Property Records."

10. **Issue**: Bell Atlantic used different pole and conduit factors for broadcast/narrowcast services and for video dialtone access link/messaging port services. (NJCTA Opp., at 26.)

    Response: Bell Atlantic did inadvertently use different factors due to a change in the factors between the time the initial cost study for the tariff was performed and the tariff filing date. When the cost study was initially prepared, the pole factor was .1242 and the conduit factor was .7250. When the studies were updated for this tariff filing, a more current pole factor of .1170 and conduit factor of .7200 were used for the broadcast and narrowcast channels but, due to an oversight, were not used for calculating the pole and conduit investment associated with the access link and messaging port services. If the more recent pole and conduit factors had also been applied to the access link and messaging port services, the difference in the investment calculation would be immaterial. Moreover, the comparison of pole attachment and conduit charges in Attachment H(1) was calculated on the basis of the more current pole and conduit factors.

11. **Issue**: In comparing Bell Atlantic's pole and conduit investment for this service with the amount Bell Atlantic charges cable operators per pole attachment or per conduit foot, Bell Atlantic should have used only those costs imputed to video, not total investment (including shared investment) per potential subscriber. In addition, the conduit cost imputed to video dialtone service is substantially less than that paid by cable operators. Cable operators must lease a whole sheath from Bell Atlantic, but Bell Atlantic is not requiring its video dialtone service to lease an entire sheath. (NJCTA Opp., at 27-28.)

Response: Like Bell Atlantic, cable may use the facilities they lease to provide multiple services -- not only video services, but also telephony, data or other services -- and allocate an appropriate portion of its use of that shared facility among each of the services it provides through that facility, as Bell Atlantic has done.

12. **Issue**: Bell Atlantic requires cable operators to remove their pole attachments or authorize Bell Atlantic to replace the pole at the cable operator's expense, if Bell Atlantic needs the space occupied by the cable operator's attachments for its own requirements. Moreover, the cable operator must purchase and maintain insurance related to its use of Bell Atlantic's poles and conduits. Bell Atlantic should have to impose similar costs on its video dialtone service. (NJCTA Opp., at 29.)

Response: Under the terms and conditions for pole attachments approved by the New Jersey Board of Public Utilities, cable operators have two choices: they may either (1) pay lower attachment rates to Bell Atlantic on the condition that Bell Atlantic may require them to remove their attachments or pay to replace the pole if Bell Atlantic needs to use all of its property for its own purposes, or (2) pay higher attachment rates in order to obtain irrevocable rights for their attachment. All of the cable operators have opted to pay the lower rate in return for revocable rights.

It is prudent and appropriate for Bell Atlantic to require third parties using its property to obtain adequate insurance to cover any damage they may cause. Bell Atlantic effectively self-insures for any damage occurring on its property in the course of providing any regulated service, including video dialtone service. Cable's desire to impose additional costs on this service is without merit.

B

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SUPPLEMENTAL AFFIDAVIT OF

WILLIAM E. TAYLOR, PH.D.

December 20, 1995

Supplemental Affidavit of
William E. Taylor, Ph.D.

I, William E. Taylor, being duly sworn, depose and say:

1. I am Senior Vice President of National Economic Research Associates, Inc. (NERA), head of its telecommunications practice and of its Cambridge office, located at One Main Street, Cambridge, Massachusetts 02142. I filed affidavits previously in this matter on March 6 and October 26, 1995. A description of my qualifications and a copy of my vita was presented in the March 6 affidavit.

2. On October 26, 1995, Bell Atlantic filed its response to the Federal Communications Commission's (Commission's) order outlining issues for investigation regarding Bell Atlantic's video dialtone tariff in Dover Township, New Jersey.[1] Various video and telephone competitors filed comments on Bell Atlantic's response on November 30, 1995, and I prepared this Supplemental Affidavit at the request of Bell Atlantic to respond to economic issues raised by those intervenors. In particular, I respond to three principal issues raised by the cable industry: (i) application of the economic definition of standalone costs and cross-subsidization, (ii) the variation of overhead costs with the supply of video dialtone (VDT) service, and (iii) the relationship between price cap regulation of Bell Atlantic's interstate and intrastate services in New Jersey and its purported ability and incentive to cross-subsidize VDT service. I also address four additional economic questions raised by intervenors: (iv) the proper economic recovery of startup costs, (v) reasonable interest rates for different classes of delinquent customers, (vi) the

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[1] Bell Atlantic Telephone Companies Revisions to Tariff F.C.C. No. 10 Rates, Terms and Regulations for Video Dialtone Service in Dover Township, New Jersey, Order Designating Issues for Investigation, ("Investigation Order"), CC Docket No. 95-145 (released September 8, 1995).

effect of VDT service on separations factors, and (vii) whether services that are comparable in some respects should recover a similar proportion of overhead costs.

A. Bell Atlantic has correctly applied economic costing principles and has followed the Commission's Rules in assigning costs to its VDT services.

3. Under the Commission's VDT rules, Bell Atlantic is required to assign to VDT services all of the "direct costs" caused by the provision of VDT services in Dover Township plus a reasonable allocation of overhead costs. Those rules define direct costs, for VDT services, to include (i) the direct costs of the primary plant investment used to supply VDT service, (ii) the incremental costs associated with the shared plant used to provide VDT and other services caused by the decision to provide VDT service, (iii) a reasonable allocation of other costs (unrelated to the provision of VDT service) associated with the shared plant used to supply VDT and other services, and (iv) costs in accounts other than primary plant that are identifiable as incremental costs of VDT service. From an economic perspective, VDT prices that recover these costs involve neither cross-subsidy nor predation because they necessarily exceed the forward-looking incremental cost of the service

4. The cable industry attempts to rewrite both the Commission's Rules and the basic principles of economics. On its behalf, Dr. Leland Johnson claims that Bell Atlantic is "seeking to subsidize its entry into video... with revenues from its monopoly local telephone ratepayers" because it assigns more investment to voice services than required for a stand alone narrowband voice network.[2] This claim was made by NCTA in its previous comments[3] and was rejected as a matter of principle by the Common Carrier Bureau in its *Dover Order*[4] for two reasons. First,

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[2] Declaration of Leland L. Johnson, Ph.D., Exhibit A to the National Cable Television Association (NCTA), "Opposition to Direct Case," CC Docket No. 95-145, November 30, 1995, ("Johnson Declaration") at 2.

[3] NCTA, Petition to Reject, or in the Alternative, to Suspend and Investigate Bell Atlantic's Video Dialtone Tariff for the Dover System, February 21, 1995, at 16-17.

[4] Bell Atlantic Telephone Companies Revisions to Tariff F.C.C. No. 10 Rates, Terms, and Regulations for Video Dialtone Service in Dover Township, Transmittal Nos. 741, 786, CC Docket No. 95-145, Order, ("Dover Order"), Released June 9, 1995.

the Commission recognized the fact that the telephone network is evolving to provide many new services and that not all of the shared costs in excess of standalone costs of a narrowband telephone network should be assigned to VDT service:

> because the telephone network is constantly being upgraded, the question is not simply whether or not all costs above the existing costs of telephony should be assigned to video dialtone service. Rather, the issue is how much of the costs are incremental to the cost of providing an expanding array of services over the telephone network. In other words, it is incorrect to view all changes to the present telephone system as incremental to video dialtone service because a portion of those changes would have been made to the system as part of the normal upgrade, with or without the decision to provide video dialtone. (*Dover Order* at ¶ 27).

5. Second, the Dover Order corrects NCTA's (and Dr. Johnson's) accounting which seeks to assign to Bell Atlantic's Dover Township VDT service all costs of the broadband network in excess of those they assert to be the forward-looking standalone costs of a modern narrowband telephone network. As the Commission noted:

> [B]ecause video dialtone is not the only new service that may be provided over an upgraded telephone network, it may not be correct to assign all costs that are incremental to telephony to video dialtone service. Thus, the real question is which portions of the network upgrade were due to a decision by the LEC to provide video dialtone (*Dover Order* at ¶ 27).

At issue in the Dover VDT Tariff is the assignment of costs to the particular VDT service currently tariffed in Dover Township. What shared costs are assigned to – and what prices will be charged for – Bell Atlantic's various narrowband or broadband telephony services or broadband video services other than this VDT service in Dover Township will be addressed in other proceedings. Thus, the claim that

> Bell Atlantic proposes to charge to telephony $1191 per potential subscriber, compared to a stand-alone cost for a new narrowband (digital loop carrier) network that might cost in the neighborhood of $700[5]

[5] Johnson Declaration, at 15.

is pure fantasy. Bell Atlantic has simply filed a tariff for one of a multitude of services that will use its network at a price that more than covers the additional costs the service imposes on the network. What Bell Atlantic may charge to telephone or other video service subscribers in the future will depend on costs and market conditions for those services and will be subjected to pervasive federal and state regulation. And even if it turned out that Bell Atlantic could not recover its total costs in its new network by charging its proposed VDT rates and regulatorily-determined just and reasonable prices for other services, VDT service would still not be subsidized because the prices for the service would exceed its incremental cost.

1. Even if basic telephone costs are higher in the new network, it does not follow that subscribers should pay for only a POTS line.

6. Citing the Johnson Declaration, the cable companies urge the Commission to require Bell Atlantic to demonstrate that the telephone portion of its new network is superior to its current network (or various alternative telephone-only networks) because the cost allocated to telephony is allegedly higher than its current costs or its costs under various alternative telephone network designs.[6] Irrespective of the numbers, the principle enunciated here is incorrect. In competitive, unregulated markets, prices of individual products or services can rise when new technology or tastes change and the mix of new products or services changes. The classic example is provided by A.E. Kahn and W.B. Shew:

> Competitive markets have the virtue of offering consumers a variety of price and quality options, but that spectrum of offerings is not unlimited. It is not economically feasible to provide all conceivable packages. For example, there may be some automobile buyers who would prefer to buy cars without bumpers or fenders, at a correspondingly reduced price; but in view of the economies of producing standardized models, it probably would actually be more costly to satisfy their idiosyncratic desires than to supply them with the models preferred by the great majority of customers. In that event, they have no legitimate

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[6] See, e.g., New Jersey Cable Television Association at 6-7, Adelphia at 8-9, and NCTA at 12.

> complaint about not having available to them, at a lower price, a stripped-down version that would have to be custom-made.[7]

Specializing the example to the decision to supply both local and long distance service using a single network, Kahn and Shew observe that

> [t]he kind of telephone network that we have, in short, inevitably represents a *collective consumption decision*. Because it would probably have been impractical for telephone companies to offer two or more systems, of varying capability, it became necessary to decide, *in effect*, collectively, which quality offered the largest differential between benefits and costs to all subscribers together.[8]

In the current example, taking all benefits and costs of narrowband and integrated networks into account, if the integrated network provides the largest difference between benefits and costs for all subscribers taken together, that network should be built and subscribers who use only narrowband services should nonetheless pay at least the incremental cost they impose on the integrated network, even if that price exceeds their current price.

7. MCI would effectively place a cost-allocation ceiling on telephone services based on current consumer choice and technology.[9] Such an allocation is not the way the prices would be set in unregulated competitive markets, and in regulated markets, pricing by such a rule would be inefficient and would deny customers the benefits of new services. Kahn and Shew demonstrate this fallacy in the context of a local exchange carrier (LEC) that offers various sophisticated services in addition to ordinary voice telephony.

> The first question is *whether those investments are economically efficient*, minimizing the combined costs of access, calling, and the newer services; and in this assessment it is necessary to take into account the sufficiency of the incremental net revenues flowing from the services the investments make it

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[7] Alfred E. Kahn and William B. Shew, "Current Issues in Telecommunications Regulation: Pricing," *Yale Journal on Regulation*, Vol. 4, Number 2, Spring 1987, at 230-231.

[8] *Ibid*, at 231.

[9] Bell Atlantic Telephone Companies Revisions to Tariff F.C.C. No. 10 Rates, Terms, and Regulations for Video Dialtone Service in Dover Township, Transmittal Nos. 741, 786, CC Docket No. 95-145, MCI Opposition to Direct Case, November 30, 1995, at 16.